

No. 11980

United States
Circuit Court of Appeals
for the Ninth Circuit

WILSON BROS. & CO.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Transcript of Record

Upon Petition to Review a Decision of The Tax Court
of the United States

FILED
AUG 18 1948

PAUL P. O'BRIEN

INDEX

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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APPEARANCES

For Petitioner:

GEORGE M. NAUS, Esq.,
CHARLES N. WHITEHEAD, C.P.A.,
A. T. MURPHY, C.P.A.

For Respondent:

T. M. MATHER, Esq.

Docket No. 11853

WILSON BROS. & CO.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DOCKET ENTRIES

1946

Aug. 20—Petition received and filed. Taxpayer notified. Fee paid.

Aug. 21—Copy of petition served on General Counsel.

Aug. 20—Request for hearing at San Francisco, filed by taxpayer. 5/28/46 Granted.

Oct. 9—Answer filed by General Counsel.

Oct. 18—Copy of answer served on taxpayer. (San Francisco, California.)

1947

Mar. 28—Hearing set May 26, 1947—San Francisco, California.

Apr. 23—Notice of filing appearance of A. Thomas Murphy as counsel filed.

May 27—Hearing had before Judge Johnson on merits. Consolidated with No. 11852. Stipulation of facts filed. Briefs due 7/11/47. Reply 8/25/47.

June 23—Transcript of hearing 5/27/47 filed.

July 8—Brief filed by taxpayer. 7/10/47 Copy served.

Aug. 22—Reply brief filed by taxpayer. Copy served.

1948

- Feb. 5—Findings of fact and opinion rendered. Judge Johnson. Decision will be entered under Rule 50. 2/10/48 Copy served.
- Apr. 14—Respondent's computation for entry of decision filed.
- Apr. 22—Hearing set May 12, 1948, on settlement.
- May 7—Consent to settlement filed.
- May 18—Decision entered. Judge Johnson. Div. 10.
- June 30—Stipulation designating venue filed.
- June 30—Petition for review by U. S. Circuit Court of Appeals, 9th Circuit, filed by taxpayer.
- June 30—Statement of points filed by taxpayer.
- June 30—Designation of printing record filed by taxpayer.
- June 30—Designation of record filed by taxpayer.
- July 2—Proof of service of filing petition for review, statement of points, designation of record and designation of printing filed. [1*]

*Page numbering appearing at foot of page of original certified Transcript of Record.

Tax Court of the United States

Docket No. 11853

WILSON BROS. & CO.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR REVIEW OF DEFICIENCY
DETERMINATIONS

The above-named petitioner hereby petitions for a redetermination of the deficiencies set forth by the Commissioner of Internal Revenue in his notice of deficiency (Bureau symbols LA:IT:90D:PAK) dated May 29, 1946, and as a basis of its proceeding alleges as follows:

1. The petitioner is a Nevada corporation with its principal office at 1112 Russ Building, San Francisco 4, California. The returns for the period here involved were filed with the Collector for the Sixth District of California, on the calendar year basis.

2. The notice of deficiency (a copy of which is attached and marked Exhibit A) was mailed to the petitioner on May 29, 1946.

3. The taxes in controversy are income taxes and personal holding company surtaxes for the calendar years 1938 to 1942, both inclusive, as follows: [2]

INCOME TAX

Year	Alleged Liability	Assessed	Alleged Deficiency	25% Penalty
1938	\$ 432.68	\$	\$ 432.68	
1939	315.26	.....	315.26	
1940	547.91	249.66	298.25	
1941	573.44	348.57	224.87	
1942	1,353.95	869.08	484.87	\$ 338.49
Totals	\$ 3,223.24	\$1,467.31	\$ 1,755.93	\$ 338.49

PERSONAL HOLDING COMPANY SURTAX

Year	Alleged Liability	Assessed	Alleged Deficiency	25% Penalty
1938	\$ 10,066.65	\$	\$ 10,066.65	\$ 2,516.66
1939	23,494.70	.....	23,494.70	5,873.68
1940	32,019.46	.....	32,019.46	8,004.87
1941	17,763.09	.....	17,763.09	.....
1942	20,152.40	.....	20,152.40	5,038.10
Totals	<u>\$103,496.30</u>	<u>\$</u>	<u>\$103,496.30</u>	<u>\$21,433.31</u>

4. The determination of taxes set forth in the said notice of deficiency is based upon the following errors:

(a) In determining the tax liabilities of petitioner, for both income tax and personal holding company surtax, for each of the years from 1938 to 1942, both inclusive, the Commissioner erroneously disallowed deductions for salaries of F. A. Wilson and W. T. Wilson to the extent of excess over \$3,000.00 per year for each of them, the disallowed excess being in the following amounts:

Year	F. A. Wilson	W. T. Wilson	Total
1938	\$15,000	\$9,000	\$24,000
1939	5,000	5,000	10,000
1940	5,000	5,000	10,000
1941	3,000	3,000	6,000
1942	5,000	5,000	10,000

(b) In determining the tax liabilities of petitioner for personal holding company surtax for each of the years from 1938 to 1942, both inclusive, the Commissioner erroneously disallowed deductions "in connection with the upkeep of certain boats", in computing Title IA and Subchapter A net income, under Section 406(b) of the Revenue Act of 1938 and Section 505(b) of the Internal Revenue Code. [3]

Said disallowed deductions are in the following amounts:

Year	Amount
1938	\$12,459.96
1939	15,094.35
1940	15,028.68
1941	16,166.87
1942	12,898.05

(c) In determining the tax liabilities of petitioner for personal holding company surtax for each of the years from 1938 to 1942, both inclusive, the Commissioner erred in not allowing any dividends paid credit beyond \$12,000.00 in the year 1941 and \$23,500.00 in the year 1942 and a dividend carryover of \$21,414.71 from 1937.

(d) In determining the tax liabilities of petitioner, for both income tax and personal holding company surtax, for each of the years from 1938 to 1942, both inclusive, the Commissioner erroneously disallowed in whole or in part deductions for ordinary and necessary expenses paid or incurred during the taxable year in carrying on business; i.e., specifically, items of salaries, wages, expenses of officers, franchise taxes, automobile sales, fees of attorneys, travel expenses, telephone and telegraph, taxes, depreciation, and the like.

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(a) Through the said years 1938 to 1942, both inclusive, and as an ordinary and necessary expense paid or incurred by petitioner in carrying on its business, personal services were actually rendered to petitioner by F. A. Wilson and W. T. Wilson of a

reasonable value not less than the following amounts:

Year	F. A. Wilson	W. T. Wilson	
1938	\$18,000	\$12,000	
1939	8,000	8,000	
1940	8,000	8,000	
1941	6,000	6,000	
1942	8,000	8,000	[4]

(b) Through the said years 1938 to 1942, both inclusive, petitioner incurred expenses in accordance with the tabular statement of amounts set forth in paragraph 4(b) hereinabove, in connection with the upkeep of certain boats. The boats were not operated during those years, but were necessary to the business of petitioner. No rent or other compensation was received for or from them, and none was obtainable, during any of said years; and there was throughout a reasonable expectation that operation of the boats would result in a profit. They were boats theretofore used in the lumber business and suitable therefor, and have never been used for personal pleasure purposes nor suitable therefor.

(c) Petitioner's earnings and profits accumulated after February 28, 1913 (before giving effect to the distributions hereinafter in this sub-paragraph (c) mentioned) were as follows:

Balance, December 31, 1937.....	\$53,711.84
Net decrease 1938.....	2,149.20
Net increase 1939.....	3,826.92
Net decrease 1940.....	1,340.05
Net decrease 1941.....	1,282.72
Net decrease 1942.....	1,193.71

Petitioner was incorporated December 14, 1928. At all times since it has had issued and outstanding only one class of stock, the shares of which have been held equally by F. A. Wilson and W. T. Wilson as the sole stockholders of petitioner. Throughout the years

1938 to 1942, both inclusive, said earnings and profits have been fully distributed in money pro rata to said stockholders through cash withdrawals by them, with no preference to any share of stock as compared with other shares; i.e., each of said stockholders has had thus distributed to him his full one-half of said earnings and profits.

(d) The items of disallowed expenses specifically mentioned in subparagraph 4(d) of this petition were ordinary and necessary expenses paid or incurred during the respective taxable years 1938 to 1942, both inclusive, in carrying on petitioner's business. [5]

Wherefore, the petitioner prays that this court may hear the proceeding and determine that there is no deficiency due from the petitioner for any of the years 1938 to 1942, both inclusive.

/s/ GEORGE M. NAUS,

Attorney.

/s/ CHARLES N. WHITEHEAD,

C.P.A.

Counsel for Petitioner.

Subscribed and sworn to before me this 16th day of August, 1946.

(Seal) /s/ EMMA L. MacHUGH,

Notary Public in and for the City and County of San Francisco, State of California.

My Commission Expires Jan. 15, 1948. [6]

State of California,

City and County of San Francisco—ss.

F. A. Wilson, being duly sworn, says that he is the president of the petitioner above named, and as such

is duly authorized to verify the foregoing petition, that he has read the foregoing petition and is familiar with the statements contained therein, and that the facts stated are true.

/s/ F. A. WILSON

Subscribed and sworn to before me this 16th day of August, 1946.

(Seal) /s/ EMMA L. MacHUGH,

Notary Public in and for the City and County of San Francisco, State of California.

My Commission Expires Jan. 15, 1948. [7]

EXHIBIT A

Form 1279

SN-IT-7

Treasury Department
Internal Revenue Service
417 South Hill Street
Los Angeles 13, California

Office of Internal Revenue Agent in Charge
Los Angeles Division
LA:IT:90D:PAK
May 29, 1946

Wilson Bros. & Co.
5225 Wilshire Boulevard, Room 308
Los Angeles 36, California.

Gentlemen:

You are advised that the determination of your Income tax liability for the taxable years ended December 31, 1938 to 1942, inclusive, discloses a deficiency of \$1,755.93 and \$338.49 in penalty, and that

Exhibit A—(Continued)

the determination of your Personal Holding Company Surtax liability for the taxable years mentioned discloses a deficiency of \$103,496.30, and \$21,433.31 in penalties, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days (not counting Saturday, Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with The Tax Court of the United States, at its principal address, Washington, D. C., for a redetermination of the deficiency or deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Los Angeles, California, for the attention of LA:Conf. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Very truly yours,

JOSEPH D. NUNAN, JR.,

Commissioner,

By /s/ GEORGE D. MARTIN,

Internal Revenue Agent in Charge.

Enclosures: Statement, Form of waiver. [8]

Exhibit A—(Continued)

STATEMENT

LA:IT:90D:PAK

Wilson Bros. & Co.

5225 Wilshire Boulevard, Room 308

Los Angeles 36, California

Tax Liability for the Taxable Years Ended

December 31, 1938 to 1942, Inclusive

INCOME TAX

Year	Liability	Assessed	Deficiency	25% Penalty
1938	\$ 432.68	\$	\$ 432.68	
1939	315.26	.....	315.26	
1940	547.91	249.66	298.25	
1941	573.44	348.57	224.87	
1942	1,353.95	869.08	484.87	\$ 338.49
Totals	\$ 3,223.24	\$1,467.31	\$ 1,755.93	\$ 338.49

PERSONAL HOLDING COMPANY SURTAX

1938	\$ 10,066.65	\$	\$ 10,066.65	\$ 2,516.66
1939	23,494.70	.....	23,494.70	5,873.68
1940	32,019.46	.....	32,019.46	8,004.87
1941	17,763.09	.....	17,763.09	.....
1942	20,152.40	.....	20,152.40	5,038.10
Totals	\$103,496.30	\$	\$103,496.30	\$21,433.31

In making this determination of your tax liability, careful consideration has been given to the report of examination dated December 29, 1943, to your protest dated April 14, 1944 and to the statements made at conferences held.

It is held that the deductions for salaries of officers in the years 1938 to 1942, inclusive, were in excess of reasonable amounts for services actually rendered, computed as follows, and these amounts have been added to taxable income as reported: [9]

Exhibit A—(Continued)

1938

Salary of F. A. Wilson, president,
deducted in return\$ 18,000.00

Allowable as reasonable compensation
for services 3,000.00

Excessive deduction now restored to
taxable income \$ 15,000.00

Salary of W. T. Wilson, secretary and
treasurer, as deducted.....\$ 12,000.00

Allowable as reasonable compensation.... 3,000.00

Excessive deduction, restored to
taxable income 9,000.00

Total addition to taxable income on
account of excessive salaries..... \$ 24,000.00

1939

Salary of F. A. Wilson, deducted.....\$ 8,000.00

Allowable 3,000.00

Excessive deduction \$ 5,000.00

Salary of W. T. Wilson, deducted.....\$ 8,000.00

Allowable 3,000.00

Excessive deduction 5,000.00

Total addition to taxable income..... \$ 10,000.00

1940

Salary of F. A. Wilson, deducted.....\$ 8,000.00

Allowable 3,000.00

Excessive deduction \$ 5,000.00

Salary of W. T. Wilson, deducted.....\$ 8,000.00

Allowable 3,000.00

Excessive deduction 5,000.00

Total addition to taxable income..... \$ 10,000.00

1941

Salary of F. A. Wilson, deducted.....\$ 6,000.00

Allowable 3,000.00

Excessive deduction \$ 3,000.00

Salary of W. T. Wilson, deducted.....\$ 6,000.00

Allowable 3,000.00

Excessive deduction 3,000.00

Total addition to taxable income..... \$ 6,000.00

Exhibit A—(Continued)

1942	
Salary of F. A. Wilson, deducted.....	\$ 8,000.00
Allowable	3,000.00
Excessive deduction	\$ 5,000.00
Salary of W. T. Wilson, deducted.....	\$ 8,000.00
Allowable	3,000.00
Excessive deduction	5,000.00
Total addition to taxable income.....	\$ 10,000.00

Expenses incurred in 1938 to 1942, inclusive, in the respective amounts of \$12,459.96, \$15,094.35, \$15,-028.68, \$16,166.87 and \$12,898.05, in connection with the upkeep of certain boats, are not allowed as deductions in computing Title 1A and Subchapter A net income, under Section 406(b) of the Revenue Act of 1938 and Section 505(b) of the Internal Revenue Code.

A dividend carry-over of \$21,414.71 from 1937 is allowable to you as a credit in the determination of Undistributed Title 1A net income subject to surtax for 1938 but no dividend carry-overs are available as credits in the determination of Undistributed Subchapter A net income of the years 1939 to 1942, inclusive. [11]

It is held that you did not file a corporation income tax return for the year 1942 as required by law. Accordingly, a penalty of 25% has been asserted.

Inasmuch as you failed to file personal holding company returns for the taxable years ended December 31, 1938, 1939, 1940 and 1942 within the time prescribed by law 25 per centum of the tax has been added thereto in accordance with the provisions of

Exhibit A—(Continued)

section 291 of the Revenue Act of 1938 and the Internal Revenue Code.

A copy of this letter and statement has been mailed to your representative, Mr. J. B. Scholefield, 523 West Sixth Street, Los Angeles 14, California, in accordance with the authorization contained in the power of attorney executed by you.

ADJUSTMENTS TO NET INCOME

Taxable Year Ended December 31, 1938

Net income as disclosed by return (Loss).....(\$ 8156.05)

Unallowable deductions and additional income:

(a) Compensation of officers		
disallowed	\$24,000.00	
(b) Salaries and wages disallowed.....	300.00	
(c) Rent disallowed	370.00	
(d) Bad debts disallowed.....	1,295.79	
(e) Federal income tax disallowed.....	52.98	
(f) Excessive depreciation disallowed..	5,043.74	
(g) Personal expense of officers		
disallowed	1,294.33	
(h) Gain on sale of automobile.....	100.00	32,456.84
		<hr/>
Total.....		\$ 24,300.79

Reduction:

(i) Decrease of income from dividends.....	1,224.50
	<hr/>

Net income adjusted.....\$ 23,076.29

EXPLANATION OF ADJUSTMENTS

(a) This adjustment has been previously explained. [12]

(b) Included in the amount of salaries and wages, \$3,900.00, claimed in your return is the amount of \$300.00 representing a loan to one of your employees. It has been determined that the amount of such loan was not compensation for services rendered by the employee and the deduction claimed is, accordingly, disallowed.

Exhibit A—(Continued)

(c) It has been determined that the correct amount of the deduction for rent is \$1,100.00 instead of the amount, \$1,470.00, claimed in your return, or a decrease of \$370.00.

(d) The deduction claimed for bad debts, representing advances for expenses of the Steamship Svea, is disallowed as not representing a proper deduction under section 23(k) of the Revenue Act of 1938.

(e) Included in the amount of other deductions claimed in item 26 of your return is the amount of federal income tax, \$52.98, paid for the taxable year ended December 31, 1937. The deduction so claimed is disallowed as not representing a proper deduction under section 23(c) of the Revenue Act of 1938.

(f) It has been determined that a reasonable allowance for depreciation for this taxable year, under section 23(1) of the Revenue Act of 1938, is the amount of \$10,275.56, instead of the amount, \$15,319.30, claimed in your return, or a decrease of \$5,043.74.

(g) For the year 1938 there was deducted upon the return \$8,622.72, as general expense. Of this amount, the following items are not allowable since they have been held to be personal expenses of the officers of the company:

Automobile expense	\$ 636.22
Telephone	158.11
Attorney's fees	500.00
	<hr/>
Total addition to taxable income.....	\$1,294.33

(h) During the taxable year you sold an automobile for \$100.00 and the proceeds were credited to

Exhibit A—(Continued)

the asset account on your books. It has been determined that the cost of this automobile had been fully recovered through allowances for depreciation claimed and allowed prior to this taxable year. Accordingly, the amount of [13] gain realized on account of this transaction, \$100.00, is added to your income.

(i) It has been determined that a portion of the income from dividends, shown in item 12 of your return, represents distributions of other than earnings or profits as shown in the following:

Name of payor corporation	Amount included in income	Amount determined as being taxable	Difference
Transamerica Corporation	\$ 839.24	\$	\$ 839.24
Great Northern Iron Ore Company	625.00	264.20	360.80
Kennecott Copper Company	655.99	631.53	24.46
Totals	\$2,120.23	\$895.73	\$1,224.50

The amount of income from dividends shown by your return is decreased by the amount of \$1,224.50.

COMPUTATION OF INCOME TAX

Taxable Year Ended December 31, 1938

Net income adjusted	\$ 23,076.29
Less: Dividends received credit (limited to 85% of net income).....	19,614.85
Special class net income.....	\$ 3,461.44
Income tax:	
12½% of \$3,461.44	\$ 432.68
Correct income tax liability.....	\$ 432.68
Income tax assessed:	
Original, account No. 86243.....	.....
Deficiency of income tax.....	\$ 432.68

Exhibit A—(Continued)

COMPUTATION OF PERSONAL HOLDING
COMPANY SURTAX

Taxable Year Ended December 31, 1938

Inasmuch as no personal holding company return was filed for this taxable year your undistributed Title 1A net income and personal holding company surtax has been determined as shown in the following:

Net income for taxable year as determined above.....	\$	23,076.29
Addition:		
(a) Expenses not deductible		12,459.96
Total	\$	35,536.25
Less: Federal income tax as above.....		432.68
Title 1A net income.....	\$	35,103.57
Less: Dividends paid credit.....	\$	
(b) Dividend carryover	21,414.71	21,414.71
Undistributed Title 1A net income.....	\$	13,688.86

EXPLANATION

(a) and (b) These adjustments have been previously explained.

Undistributed Title 1A net income.....	\$	13,688.86
Personal Holding Company Surtax:		
65% of \$ 2,000.00.....	\$	1,300.00
75% of \$11,688.86.....		8,766.65
Correct personal holding company surtax.....	\$	10,066.65
Personal holding company surtax assessed (no return filed).....		
Deficiency of personal holding company surtax.....	\$	10,066.65
25% penalty	\$	2,516.66

Exhibit A—(Continued)

ADJUSTMENTS TO NET INCOME

Taxable Year Ended December 31, 1939

Net income as disclosed by return (loss).....(\$ 825.61)

Unallowable deductions and additional income:

(a) Compensation of officers

disallowed\$ 10,000.00

(b) Gain on sale of automobile..... 331.50

(c) Excessive depreciation disallowed 4,636.29

(d) Personal expense of officers

disallowed 2,868.05

(e) Franchise taxes disallowed 166.76 18,002.60

Total\$ 17,176.99

Additional deduction:

(f) Decrease of income from dividends..... 363.15

Net income adjusted.....\$ 16,813.84

EXPLANATION OF ADJUSTMENTS

(a) This adjustment has been previously explained.

(b) During the taxable year you sold an automobile for \$525.00 and credited the proceeds from the sale to the asset account on your books. It has been determined that you realized a gain of \$331.50 on this transaction as shown in the following:

Sale price\$525.00

Cost or basis of automobile.....\$633.80

Less: Depreciation allowed or allowable..... 440.30 193.50

Gain realized\$331.50

The amount of the gain realized from this transaction is added to your income.

(c) It has been determined that a reasonable allowance for depreciation, under section 23(1) of the Internal Revenue Code [16] for this taxable year is the amount of \$10,183.01 instead of the amount, \$14,819.30, claimed in your return, or a decrease of \$4,636.29.

Exhibit A—(Continued)

(d) You deducted a total amount of \$11,874.00 in the return for 1939, as general expense. Of this total, the following amounts are held to be personal expenses of the officers of the company:

Automobile expense	\$1,055.70
Telephone and telegraph.....	319.07
Newspapers	5.20
Travel expense	862.48
Attorney's fees	625.60
	<hr/>
Total addition to taxable income.....	\$2,868.05

(e) In your return a deduction was claimed for additional franchise taxes of prior years in the amount of \$166.76. It has been determined the liability for such taxes did not accrue during this taxable year and the deduction claimed is, accordingly, disallowed.

(f) It has been determined that a portion of the income from dividends, shown in item 12 of your return, represents distributions of other than earnings or profits as shown in the following:

Name of payor corporation	Amount included in income	Amount determined as being taxable	Difference
Transamerica Corporation	\$ 699.37	\$	\$699.37
Great Northern Iron Ore Company	625.00	558.70	66.30
Kennecott Copper Company	749.70	1,152.22	(402.52)
	<hr/>	<hr/>	<hr/>
Total	\$2,074.07	\$1,710.92	\$363.15

The amount of income from dividends shown by your return is decreased by \$363.15. [17]

Exhibit A—(Continued)

COMPUTATION OF INCOME TAX

Taxable Year Ended December 31, 1939

Net income adjusted	\$ 16,813.84
Less: Dividends received credit (limited to 85% of net income)	14,291.76
Special class net income	\$ 2,522.08
Income tax: 12½% of \$2,522.08	\$ 315.26
Correct income tax liability	\$ 315.26
Income tax assessed: Original, account No. 86288 .....	.....
Deficiency of income tax	\$ 315.26

COMPUTATION OF PERSONAL HOLDING
COMPANY SURTAX

Taxable Year Ended December 31, 1939

Inasmuch as no personal holding company return was filed for this taxable year your Undistributed Subchapter A net income and personal holding company surtax has been determined as shown in the following:

Net income for taxable year as above....	\$ 16,813.84
Add: Expenses not deductible (as previously explained)	15,094.35
Total	\$ 31,908.19
Less: Federal income tax as above	315.26
Subchapter A net income	\$ 31,592.93
Undistributed Subchapter A net income	\$ 31,592.93
Personal holding company surtax:	
65% of \$2,000.00	\$ 1,300.00
75% of \$29,592.93	22,194.70
Correct personal holding company surtax liability	\$ 23,494.70
Personal holding company surtax assessed (no return filed) .....	.....
Deficiency of personal holding company surtax	\$ 23,494.70
25% penalty	\$ 5,873.68

Exhibit A—(Continued)

ADJUSTMENTS TO NET INCOME

Taxable Year Ended December 31, 1940

Net income as disclosed by return.....	\$ 11,207.86	
Unallowable deductions:		
(a) Compensation of officers disallowed	\$ 10,000.00	
(b) Taxes disallowed	2,477.77	
(c) Personal expense of officers disallowed	1,129.21	13,606.98
		<hr/>
Total		\$ 24,814.84
Additional deductions:		
(d) Decrease of income from dividends	\$ 140.96	
(e) Interest expense	35.36	
(f) Additional depreciation	41.16	217.48
		<hr/>
Net income adjusted		\$ 24,597.36

EXPLANATION OF ADJUSTMENTS

(a) This adjustment has been previously explained.

(b) It has been determined that the correct deduction for taxes for this taxable year, under section 23(c) of the Internal Revenue Code, is \$989.56 instead of the amount, \$3,467.33, [19] claimed in your return, or a decrease of \$2,477.77.

(c) For 1940 you deducted a total amount of \$4,180.39 as general expense. Of this total, the following amounts are held not deductible since they are deemed to be personal expenses of the officers:

Automobile expense	\$ 734.78
Telephone and telegraph	293.52
Travel expense	86.16
Newspapers	14.75

Total addition to taxable income.....	\$1,129.21
---------------------------------------	------------

(d) It has been determined that a portion of the income from dividends, shown in item 12 of your re-

Exhibit A—(Continued)

turn, represents distributions of other than earnings or profits as shown in the following:

Name of payor corporation	Amount included in income	Amount determined as being taxable	Difference
Anglo National Company	\$ 200.00	\$ 58.82	\$141.18
Kennecott Copper Company	1,819.12	1,819.34	(.22)
Total	\$2,019.12	\$1,878.16	\$140.96

The amount of income from dividends shown by your return is decreased by \$140.96.

(e) An additional deduction is allowed for interest expense in the amount of \$35.36.

(f) It has been determined that a reasonable allowance for depreciation for this taxable year, under section 23(1) of the Internal Revenue Code, is the amount of \$10,174.60 instead of the amount, \$10,-133.44, claimed in your return, or an increase of \$41.16. [20]

COMPUTATION OF INCOME TAX

Taxable Year Ended December 31, 1940

Net income adjusted	\$ 24,597.36
Less: Dividends received credit (limited to 85% of net income).....	20,907.76
Normal-tax net income	\$ 3,689.60
Income tax:	
Normal tax—13½% of \$3,689.60.....	\$ 498.10
Defense tax—10% of \$498.10.....	49.81
Correct income tax liability.....	\$ 547.91
Income tax assessed:	
Original, account No. 420259.....	249.66
Deficiency of income tax.....	\$ 298.25

Exhibit A—(Continued)

COMPUTATION OF PERSONAL HOLDING
COMPANY SURTAX

Taxable Year Ended December 31, 1940

Since no personal holding company return was filed for this taxable year your undistributed Subchapter A net income and personal holding company surtax has been determined as shown in the following:

Net income as above.....	\$ 24,597.36
Add: Expenses not deductible (as previously explained)	15,028.68
Total	\$ 39,626.04
Less: Federal income tax.....	547.91
Subchapter A net income.....	\$ 39,078.13
Undistributed Subchapter A net income.....	\$ 39,078.13
Personal holding company surtax:	
65% of \$ 2,000.00.....	\$ 1,300.00
75% of \$37,078.13.....	27,808.60
Total	\$ 29,108.60
Defense tax—10% of \$29,108.60.....	2,910.86

Correct personal holding company surtax liability....\$ 32,019.46
 Personal holding company surtax assessed
 (no return filed)

Deficiency of personal holding company surtax.....\$ 32,019.46
 25% penalty

ADJUSTMENTS TO NET INCOME

Taxable Year Ended December 31, 1941

Net income as disclosed by return.....	\$ 11,065.85
Unallowable deductions and additional income:	
(a) Compensation of officers disallowed	\$6,000.00
(b) Personal expense of officers disallowed	1,169.23
(c) Income from dividends increased....	87.32
(d) Excessive depreciation	8.82
Total	\$ 7,265.37
Total	\$ 18,331.22
Reduction:	
(e) Decrease of income from sale of rights.....	126.96
Net income adjusted.....	\$ 18,204.26

Exhibit A—(Continued)

EXPLANATION OF ADJUSTMENTS

(a) This adjustment has been previously explained.

(b) There was deducted in the 1941 return a total amount of \$9,904.04 as general expense. Of this total, the following amounts are disallowed as constituting personal expenses of the officers of the company:

Automobile expense	\$ 850.36
Telephone and telegraph.....	318.87
	<hr/>
Total addition to taxable income.....	\$1,169.23

(c) In computing the amount of income from dividends reported in item 12 of your return you excluded the amount of \$2,659.35 as being the portion of certain dividends not representing distributions of earnings or profits. It has been determined that the correct amount of such dividends, representing a return of capital, is \$2,572.03, or a decrease of \$87.32, as shown in the following:

Name of payor corporation	Amount claimed as nontaxable	Amount determined as nontaxable	Decrease
Great Northern iron Ore Co.	\$ 566.81	\$ 566.80	(.03)
Kennecott Copper Company	492.54	492.57	(.03)
Anglo National Company	1,600.00	1,512.66	87.34
	<hr/>	<hr/>	<hr/>
Totals	\$2,659.35	\$2,572.03	\$87.32

The amount of \$87.32 is added to your income.

(d) It has been determined that a reasonable allowance for depreciation for this taxable year, under section 23(1) of the Internal Revenue Code, is the

Exhibit A—(Continued)

amount of \$10,303.05 instead of the amount, \$10,-311.87, claimed in your return, or a decrease of \$8.82.

(e). In your return you reported a gain of \$128.64 from the sale of rights to purchase stock. It has been determined that the correct amount of gain realized on account of this transaction is \$1.68 or a decrease of \$126.96.

COMPUTATION OF INCOME TAX

Taxable Year Ended December 31, 1941

Net income adjusted	\$ 18,204.26
Less: Dividend received credit (limited to 85% of net income)	15,473.62
Normal-tax net income	\$ 2,730.64
Surtax net income	\$ 2,730.64
Income Tax:	
Normal tax—15% of \$2,730.64	\$409.60
Surtax—6% of \$2,730.64	163.84
Correct income tax liability	\$ 573.44
Income tax assessed: Original, account No. 420153	348.57
Deficiency of income tax	\$ 224.87

COMPUTATION OF PERSONAL HOLDING
COMPANY SURTAX

Taxable Year Ended December 31, 1941

Net income adjusted	\$ 18,204.26
Add: Expenses not deductible (as previously explained)	16,166.87
Total	\$ 34,371.13
Less: Federal income tax	573.44
Subchapter A net income	\$ 33,797.69
Less: Dividends paid credit (as claimed in return)	12,000.00
Undistributed Subchapter A net income	\$ 21,797.69

Exhibit A—(Continued)

Personal holding company surtax:

71½% of \$ 2,000.00.....\$ 1,430.00

82½% of \$19,797.69..... 16,333.09

Correct personal holding company surtax.....\$ 17,763.09

Personal holding company surtax assessed:

Original, account No. 420153.....

Deficiency of personal holding company surtax.....\$ 17,763.09

ADJUSTMENTS TO NET INCOME

Taxable Year Ended December 31, 1942

Net income as disclosed by return.....\$ 23,175.37

Unallowable deductions:

(a) Compensation of officers

disallowed\$10,000.00

(b) Taxes disallowed 268.18

(c) Personal expense of officers

disallowed 2,289.52

(d) Excessive depreciation 181.36 12,739.06

Total\$ 35,914.43

Additional deduction:

(e) Interest expense 14.53

Net income adjusted\$ 35,899.90

EXPLANATION OF ADJUSTMENTS

(a) This adjustment has been previously explained.

(b) It has been determined that the correct deduction for taxes, under section 23(c) of the Internal Revenue Code, is the amount of \$740.08 instead of the amount, \$1,008.26, claimed in your return, or a decrease of \$268.18.

(c) Of the total amount of \$9,165.51 deducted in the return filed for 1942, as general expense, the following amounts are held not allowable, since they

Exhibit A—(Continued)

are deemed to be personal expenses of the company's officers:

Automobile expense	\$ 501.24
Telephone and telegraph.....	352.76
Travel expense	175.77
Attorney's fees	1,259.75
	<hr/>
Total addition to taxable income.....	\$2,289.52

(d) It has been determined that a reasonable allowance for depreciation for this taxable year, under section 23(1) of the Internal Revenue Code, is the amount of \$10,130.51 instead of the amount, \$10,-311.87 claimed in your return, or a decrease of \$181.36. [25]

(e) An additional deduction for interest expense is allowed in the amount of \$14.53.

COMPUTATION OF INCOME TAX

Taxable Year Ended December 31, 1942

Net income adjusted	\$ 35,899.90
Less: Dividend received credit (limited to 85% of net income).....	30,514.92
	<hr/>
Normal-tax net income.....	\$ 5,384.98
Surtax net income.....	\$ 5,384.98
Income tax:	
Normal tax:	
15% of \$5,000.00.....	\$750.00
17% of \$ 384.98.....	65.45
	<hr/>
	\$ 815.45
Surtax:	
10% of \$5,384.98.....	538.50
	<hr/>
Correct income tax liability.....	\$ 1,353.95
Income tax assessed: Original, account No. 702350.....	869.08
	<hr/>
Deficiency of income tax.....	\$ 484.87
25% penalty	\$ 338.49

Exhibit A—(Continued)

COMPUTATION OF PERSONAL HOLDING
COMPANY SURTAX

Taxable Year Ended December 31, 1942

Since no personal holding company return was filed for this taxable year your Undistributed Subchapter A net income and personal holding company surtax has been determined as shown in the following:

Net income	\$ 35,899.90
Add: Expenses not deductible (as previously explained)	12,898.05
Total	\$ 48,797.95
Less: Federal income tax.....	1,353.95
Subchapter A net income.....	\$ 47,444.00
Less: Dividends paid credit.....	\$ 23,500.00
Undistributed Subchapter A net income.....	\$ 23,944.00
Personal holding company surtax:	
75% of \$ 2,000.00.....	\$ 1,500.00
85% of \$21,944.00.....	18,652.40
Correct personal holding company surtax liability.....	\$ 20,152.40
Personal holding company surtax assessed (no return filed).....	.....
Deficiency of personal holding company surtax.....	\$ 20,152.40
25% penalty	\$ 5,038.10

[Endorsed]: Filed Aug. 20, 1946. [27]

[Title of Tax Court and Cause.]

ANSWER

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, J. P.

Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed by the above-named petitioner, admits and denies as follows:

1, 2 and 3. Admits the allegations contained in paragraphs 1, 2 and 3 of the petition.

4. (a) to (d), inclusive. Denies that the Commissioner erred in the determination of the deficiencies as alleged in paragraph 4 of the petition and subparagraphs (a) to (d), inclusive, thereunder.

5. (a) Denies the allegation contained in subparagraph (a) of paragraph 5 of the petition.

(b) Admits the boats were not operated; denies the remaining allegations contained in subparagraph (b) of paragraph 5 of the petition.

(c) Admits that at all times since it has had issued and outstanding only one class of stock, the shares of which have been held equally by F. A. Wilson and W. T. Wilson as the sole stockholders of petitioner; denies the remaining allegations contained [28] in subparagraph (c) of paragraph 5 of the petition.

(d) Denies the allegation contained in subparagraph (d) of paragraph 5 of the petition.

6. Denies generally and specifically each and every allegation in the petition not hereinbefore admitted, qualified, or denied.

Wherefore, it is prayed that the Commissioner's

determination be approved and the petitioner's appeal denied.

/s/ J. P. WENCHEL, TMM
Chief Counsel, Bureau of Internal Revenue.

Of Counsel:

B. H. NEBLETT,
Division Counsel.

T. M. MATHER,
Special Attorney, Bureau of Internal Revenue.

[Endorsed]: Filed Oct. 9, 1946. [29]

The Tax Court of the United States

10 T. C. No. 30

W. T. Wilson, Petitioner, v. Commissioner of Internal Revenue, Respondent.

Wilson Bros. & Co., Petitioner, v. Commissioner of Internal Revenue, Respondent.

Docket Nos. 11852, 11853.

Promulgated February 5, 1948.

1. Two brothers, sole equal shareholders of the taxpayer corporation, contributed to it cash as paid-in surplus in 1931 and orally agreed that either might make withdrawals up to \$150,000. Each did so in succeeding years, making no notes and paying no interest. The withdrawals were carried in an account receivable by the corporation and some deposits by the brothers were later credited to it.

The shareholders' withdrawals, held, on the evidence to be distribution of dividends, and not loans.

2. Amounts paid by the taxpayer corporation to its two shareholding officers, held, on the evidence to be excessive as salaries and deductible as such only to a lesser amount determined.

3. Taxpayer, a trader in securities, borrowed shares from a broker to maintain a "short" position, and paid the lender fees and amounts equivalent to dividends on the shares. Such amounts, held, deductible as expense. *Commissioner v. Wilson*, 163 Fed. (2d) 680; certiorari denied, U. S. [30]

4. The taxpayer corporation owned two lumber schooners which it used in its lumber business in 1929 and "laid up" thereafter, incurring expense in their maintenance but deriving no income from them. In 1938 it discontinued the lumber business, and its assets thereafter consisted principally of securities.

Amounts representing depreciation and maintenance expenses of the schooners, held, not deductible in computing the personal holding company surtax since the evidence fails to establish that no income was obtainable, that the schooners were held in the course of business and that there was a reasonable expectation of profit from the property, as required by section 505 (b), Internal Revenue Code, to support such deduction in the absence of income from the property.

5. Increase in credits for dividends paid, held, proper to the extent that distributions, stipulated or held to be dividends, were made pro rata and

without preference among shareholders. Section 27 (h), Internal Revenue Code.

George M. Naus, Esq., C. N. Whitehead, C.P.A., and A. Thomas Murphy, C.P.A., for the petitioners.

T. M. Mather, Esq., for the respondent.

The Commissioner determined against W. T. Wilson an income tax deficiency of \$18,504.76 for 1939; of \$11,158.19 for 1940, and of \$5,644.55 for 1941, and against Wilson Bros. & Co. deficiencies in income tax, personal holding company surtax and penalties as follows:

Year	Income Tax		Personal Holding Co. Tax	
	Deficiency	Penalty	Deficiency	Penalty
1938	\$432.68	\$	\$10,066.65	\$2,516.66
1939	315.26	.....	23,494.70	5,873.68
1940	298.25	.....	32,019.46	8,044.87
1941	224.87	.....	17,763.09	.....
1942	484.87	338.49	20,152.40	5,038.10

Petitioner Wilson charges the Commissioner with error in treating his withdrawals of funds from the corporation as dividends rather than loans; in treating portions of the amounts paid him as salary by the corporation as dividends and hence not community income, and in disallowing the deduction of amounts paid by him to brokers for the loan of securities in which he held a "short" position. The petitioner corporation charges error in the Commissioner's disallowance as deductions of the full amounts paid as salaries to its two shareholding officers; in the disallowance for personal holding company surtax purposes of the deduction of depreciation and expenses on two unused lumber schooners. It claims further additional credits for

dividends paid and the deduction of certain miscellaneous expenses, the subject of a stipulation.

FINDINGS OF FACT

Petitioner, W. T. Wilson (hereafter called petitioner), an individual residing at Los Angeles, California, filed income tax returns, prepared on the cash basis, for the years 1939, 1940 and 1941 with the collector of internal revenue for the sixth district of California. Petitioner, Wilson Bros. & Co. (hereafter called the corporation), a Nevada corporation with principal office at San Francisco, California, filed income tax returns, prepared on an accrual basis, for the years 1929-1941, inclusive, with the collector for the same district. During the years 1938-1942 the corporation was a personal holding company.

1. The corporation was organized in December 1928 by petitioner and his brother, F. A. Wilson, each of whom paid \$500 for one-half of its capital stock of \$1,000 represented by 40 shares, and thereafter they jointly contributed to paid-in surplus \$624,000 and two schooners. Each has since owned 20 shares. The brothers were successfully engaged as partners in the [32] milling, shipping and selling of lumber on the west coast of the United States. They operated logging camps and sawmills, manufacturing lumber in Washington and shipping it on the two schooners, the Oregon and the Idaho, for sale in San Francisco, Los Angeles and San Diego. The business was begun by their grandfather, continued by their father, and they participated in it

from early youth. After 1928 it was conducted by the corporation. The schooner, Oregon, in which the brothers owned a 100 percent interest, and the schooner, Idaho, in which they owned a 75 percent interest, were transferred to the corporation at a value of \$175,000. As an additional contribution to paid-in surplus the brothers on March 20, 1931, transferred to the corporation a bank account of \$480,372.24, which they had received as a gift from their mother. At the time of this transfer it was orally agreed between them that either might at any time make withdrawals not exceeding \$150,000 from the corporation and repay the amounts without interest when convenient to the drawer or necessary for the corporation's business.

In 1932 petitioner made an initial withdrawal of \$17,717.88, and on January 1, 1939, the balance due from him, as shown on the corporation's books, was \$75,417.88. In 1939 and 1940 he made withdrawals aggregating \$45,000 and \$16,000, respectively, increasing the balance shown as due from him to \$136,417.88. In and after 1938 F. A. Wilson likewise made substantial withdrawals, \$50,000 in 1939 and \$11,000 in 1940. Both have made occasional payments, which were credited to their respective accounts. As of January 2, 1945, the corporation's books showed as due from them on account of withdrawals, \$99,917.88 and \$94,500, respectively. At all times each has been financially able to repay the amount of his withdrawal. No notes were made to evidence an indebtedness, but the debits and credits reflecting withdrawals [33] and payments were car-

ried on the corporation's books in an account receivable. Petitioner's accumulated earnings and profits were at the end of 1938, \$89,420.45; at the end of 1939, \$93,247.38; and at the end of 1940, \$91,907.32, without adjustments for tax deficiencies determined or to be determined. Petitioner's withdrawals were not loans but dividends.

2. With the cash contributions of petitioner and his brother the corporation purchased stocks, principally of domestic corporations. In 1938 and succeeding years its security holdings exceeded \$800,000 in value, and it derived over 80 percent of its income from dividends. F. A. Wilson, its president and general manager, and petitioner, its secretary and treasurer, gave attention to its investments. During the taxable years they followed market reports, made some slight changes in holdings, exercised rights, and once purchased stocks with the proceeds of some matured bonds. F. A. Wilson had charge of maintaining and repairing the two schooners which were not in use; of finances and collections, and the preparation of tax returns. In 1940 he exerted unusual efforts in preparing for the presentation of a tax case by the corporation. He and petitioner were both active in seeking a purchaser or lessor for the schooners, and in 1939 he made an unsuccessful trip to the northwestern states in search of lumber. He was a member of the San Francisco Stock Exchange, and operated a brokerage business. He also looked after his personal security portfolio, containing stocks of a value of about \$200,000. Petitioner kept the cor-

poration's accounts; he also engaged in a retail lumber business at Los Angeles, which he took over from the corporation in 1938 and from which he reported gross income of \$184,000 in 1939, \$127,000 in 1940, and \$187,000 in 1941. He engaged a manager at [34] \$300 a month for this business. In 1938 the corporation ceased to deal in lumber, and its only business was the care of investments and the collection of dividends and a small amount of rent.

Prior to 1936 petitioner and his brother received no salaries from the corporation. In 1936, 1937 and 1938 each received an annual salary of \$12,000, and in 1938 F. A. Wilson was paid a special fee of \$6,000 for his work in connection with the tax litigation. In 1939, 1940 and 1942, each was paid an annual salary of \$8,000 and in 1941 of \$6,000. Petitioner and his wife each reported one-half of this salary for 1939, 1940 and 1941 as community income. A reasonable annual compensation for the services of petitioner and his brother to the corporation during the taxable years was \$6,000 each.

3. During 1939, 1940 and 1941 petitioner was a trader in securities, and to maintain a "short" position, borrowed certain stocks. He paid to the lender brokerage firms amounts equivalent to dividends on the stocks as follows: 1939, \$3,900; 1940, \$4,150; 1941, \$4,400. In addition he paid the lenders \$20 in 1939 and \$339.85 in 1941 as premiums for loan of the stocks. The Commissioner disallowed the deduction of \$3,900 in 1939, \$4,150 in 1940, and

\$4,736 in 1941, treating these amounts as part of the cost of covering purchases.

4. The two schooners, transferred to the corporation, are wooden-hulled boats of 1,800 tons, dead weight, with cargo space for 1,200,000 board feet of lumber. After being operated by the corporation for a part of the year 1929, they were "laid up" because a lull in the lumber market left petitioner with large unsold stocks on hand. For some years thereafter petitioner and [35] his brother expected to put the boats back into service, shipping lumber in them again when market conditions should improve. But in succeeding years such conditions grew worse, and the boats have never been used. They have been kept moored, however, under the care of a watchman who cleans and paints the superstructure, and at intervals of 15 to 18 months they are placed in drydock for general overhauling, caulking and repairs. While not seaworthy since 1929, they have been maintained in such a condition that they could be made so within a period of 60 to 90 days.

In 1938 petitioner took over individually a retail branch of the corporation's business, selling pine to motion picture studios and others from the office and lumber yard which the corporation formerly used. Since that year the corporation has not dealt in lumber or derived any income from its sale. During the years 1938-1942 numerous efforts were made to sell or lease the boats, some offers were received but not accepted. Being of wood the schooners are

inferior to ships having steel hulls and can not be as readily leased or sold. During the war they were not desired by the Maritime Commission because slow and small. For the years 1938-1942 the following amounts were claimed and allowed for income tax purposes as depreciation and expenses connected with them:

Year	Total	Depreciation	Expenses
1938	\$12,459.96	\$10,002.08	\$2,457.88
1939	15,094.35	10,002.08	5,092.27
1940	15,028.68	10,002.08	5,026.60
1941	16,166.87	10,002.08	6,164.79
1942	12,898.05	10,002.08	2,895.97

These amounts were not allowed as deductions in the determination of the corporation's personal holding company surtax. The corporation received no rent or other compensation for the use of the boats in 1938, 1939, 1940, 1941 and 1942; the boats were not held in the course of the corporation's business in those years and were not necessary to the conduct of that business.

OPINION

Johnson, Judge: 1. Petitioner assails the determination that withdrawals of \$47,500 (stipulated, however, to be \$45,000) in 1939 and of \$16,000 in 1940 were dividends paid to him by the corporation and not loans, as he contends. He stresses in support of his view, the informal understanding between his brother and himself when their mother's gift of cash was contributed to paid-in surplus; the charging of the withdrawals to their personal accounts; the crediting of them to the corporation's account receivable, and some repayments made by

each shareholder. By section 115 (a) of the Internal Revenue Code a dividend is defined to be any distribution made by a corporation to its shareholders out of earnings or profits, and by 115 (b) "every distribution is made out of earnings or profits to the extent thereof." Hence petitioner's withdrawals are to be deemed distributions, as determined, unless he can affirmatively establish their character as loans, and since the corporation was wholly owned by the two withdrawers, their control invites a special scrutiny. Ben R. Meyer, 45 B.T.A. 228.

We are of opinion that the evidence indicates dividends rather than loans. While true that the absence of notes, the failure to pay interest and the lack of a written agreement are not of themselves conclusive of this view, it is equally true that the recording of withdrawals in accounts receivable and the credits entered in such accounts are likewise inadequate to establish loans. [37] The issue must be decided upon an examination of all the pertinent facts found, and when they are examined, the emerging picture is that of two brothers, always closely associated in business, who own and completely control a corporation to which they jointly contributed over a million dollars in cash as paid-in surplus and from which they drew money at will, making occasional returns of lesser amounts credited to their accounts. The ceiling for such withdrawals and the obligation to repay them on call, being unevicenced by written agreement or corporate resolution, could have been changed by

an oral understanding between the brothers as easily and as informally as it was made. Such a vague arrangement is not determinative for tax purposes; and as the corporation had earnings and profits in 1939 and 1940, we hold that the withdrawals were dividend distributions to the extent thereof. Ben R. Meyer, *supra*; James J. Gravley, 44 B.T.A. 722; Moses W. Faitoute, 38 B.T.A. 32; Roy J. Kinnear, 36 B.T.A. 153; dismissed (C.C.A., 9th Cir.), 95 Fed. (2d) 997; George P. Marshall, 32 B.T.A. 956; M. Jackson Crispin, 32 B.T.A. 151. Petitioner cites *Weaver v. Commissioner* (C.C.A., 9th Cir.), 58 Fed. (2d) 755, as to the contrary, but we perceive a material distinction in that the \$100,000 which was therein contributed to a corporation by its several shareholders under an oral understanding that it would be returned, was simultaneously repaid to all in the exact amount of each one's contribution.

The Commissioner's determination that the withdrawals were dividends is sustained as to \$45,000 in 1939 and \$16,000 in 1940.

2. The corporation paid \$12,000 to petitioner and \$18,000 to F. A. Wilson in 1938 as salary and so paid to each \$8,000 in 1939, 1940 and 1942, and \$6,000 in 1941. Under the view that the services of each were worth no more than \$3,000 in each year, the Commissioner disallowed to the corporation the [38] deduction of the excess paid above that amount and treated such excess as dividends, not salary, in determining petitioner's tax for each of those years. Both determinations are assailed.

To justify the salary paid, petitioner and his brother testified that each devoted an average of 35 hours a week to business of the corporation. As the corporation ceased to deal in lumber in 1938, such services were limited to care of investments, maintenance of the schooners and efforts to sell or lease them. There is also testimony that a search was made for a lumber supply with which to revive the corporation's lumber business, but this purpose seems hardly consonant with the transfer of its retail business to petitioner in 1938 and efforts to dispose of the schooners which had been used in that business. While the investment portfolio had a market value in excess of \$800,000 during the years in controversy, the witness mentioned in general terms only "slight changes in holdings" and the purchase of stock with the proceeds of some matured bonds. They stressed the need for following market reports closely; work on income tax matters and attention to the schooners (which, however, were not in operation or even seaworthy), and their repeated but unsuccessful efforts to sell or lease them. They also stress that no salaries were paid them prior to 1936, but such prior years are not in controversy.

We are not persuaded that the value and extent of the brothers' services to the corporation were as great as they assert. Petitioner was operating a lumber business of his own on which he reported a gross annual income of from \$127,000 to \$187,000, and F. A. Wilson, a member of the San Francisco Stock Exchange, was operating a brokerage firm.

Under such circumstances it is not reasonable to suppose that their principal activities were connected with [39] affairs of a personal holding company, which held only securities and "laid up" lumber boats, and their testimony confirms rather than rebuts this view. Neither could cite any steady corporate business, but referred vaguely to occasional need for attention to the boats, occasional efforts to sell or lease them, to tax work, and to "slight changes" in investments. On these facts we deem an annual salary of \$6,000 to each reasonable and reverse the Commissioner's determination to this extent. Cf. Wagegro Corporation, 38 B.T.A. 1225.

3. Petitioner was a trader in securities, and having borrowed shares from a broker to maintain a "short" position, he paid the lender \$3,900 in 1939, \$4,150 in 1940, and \$4,400 in 1941, the equivalent of dividends on such shares. He also paid a premium or fee of \$20 in 1939 and \$339.85 in 1941. The Commissioner determined that "amounts of \$3,900.00, or \$4,150.00 and \$4,736.00" paid as dividends on borrowed stock were "not allowable as deductions from gross income, but are held to be a part of the cost of stock purchased to cover the short sales." Petitioner assails this determination as error, and we agree. Amounts so paid "were not incurred as an incident either to the acquisition or sale of the property involved, but are more in the nature of carrying charges incurred during the progress of the deal," and are deductible. *Commissioner v. Wiesler* (C.C.A., 6th Cir.), 161 Fed.

(2d) 997; affirming 6 T.C. 1148; certiorari denied, U.S., (December 15, 1947); *Commissioner v. Wilson* (C.C.A., 9th Cir.), 163 Fed. (2d) 680; certiorari denied, U.S. (December 15, 1947).

4. In determining the corporation's personal holding company surtax for the years 1938-1942, the Commissioner disallowed as deductions the amounts representing depreciation and expenses connected with the two schooners although such amounts were deducted in his determination of the corporation's income tax. The corporation assails the disallowance and respondent defends his action on the ground that the schooners were not properly of the kind required by section 505 (b), Internal Revenue Code, to support the deduction. This section, defining Subchapter A Net Income for computation of surtax on a personal holding company, limits the deductions available under section 23 (a), relating to expenses, and section 23(1), relating to depreciation, to an amount equal to rent or other compensation from the property affected unless it is established to the Commissioner's satisfaction:

(1) That the rent or other compensation received was the highest obtainable, or, if none was received, that none was obtainable;

(2) That the property was held in the course of a business carried on bona fide for profit; and

(3) Either that there was reasonable expectation that the operation of the property would result in a profit, or that the property was necessary to the conduct of the business.

Since the corporation derived no income what-

and maintenance expense because the boats were not used in a business or transaction for profit. And in our opinion it was the intention of Congress in enacting 505 (b) that the corporation holding them be in no more favorable a position for claiming such deductions. Accordingly we sustain the Commissioner's disallowance.

5. The corporation charges error in that the Commissioner failed to allow credit for dividends paid "beyond \$12,000" in 1941, \$23,500 in 1942 and a dividend carry-over of \$21,414.71 from 1937. Just what additional credits are sought is not clear from the assignment of error, but in a stipulation the Commissioner "concedes" that the corporation "paid a cash dividend of \$12,000.00 in December 1940, at the rate of \$6,000.00 each to F. A. Wilson and W. T. Wilson." By brief petitioner contends that any parts of the salaries which may be disallowed should likewise be treated as dividends paid, while respondent, advertising to shareholders' withdrawals, which he contended and which we hold to have been dividend distributions, argues that since different amounts were distributed to each shareholder, no additional credit should be given the corporation because the distribution was not pro rata, as required [43] to support a credit by section 27 (h), Internal Revenue Code, and he stresses that this section has been strictly construed. *Safety Convoy Co., Inc. v. Thomas* (C.C.A., 5th Cir.), 139 Fed. (2d) 219. See also *Black Motor Co., Inc. v. Commissioner* (C.C.A., 6th Cir.), 125 Fed. (2d) 977. Obviously the condition is not met

in respect of the withdrawals and the \$6,000 special fee paid to F. A. Wilson in 1938, and no dividends paid credit should be allowed on account of those distributions. *Spring Street Realty Co. v. Commissioner* (C.C.A., 3rd Cir.), 123 Fed. (2d) 146, affirming a Memorandum Opinion entered July 21, 1941. But as the regular salaries paid and the excesses disallowed were equal and therefore proportionate to shareholdings, the amounts of the excesses should be reflected in the credits sought. The same is true of the \$12,000 covered by stipulation.

In addition the parties have stipulated that the corporation is entitled to a number of itemized expense deductions in addition to those allowed by the Commissioner, and these should be reflected in the computation of tax.

Reviewed by the Court.

Decisions will be entered under Rule 50. [44]

The Tax Court of the United States, Washington
Docket No. 11853

WILSON BROS. & CO.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the Court's findings of fact promulgated February 5, 1948, the respondent herein filed

United States Circuit Court of Appeals for the Ninth Circuit to review the decisions entered May 18, 1948, for the respective years 1938 to 1942, both inclusive, ordering and deciding that there are deficiencies in personal holding company surtaxes for those years, due from this petitioner on review. This petition for review is filed pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code and of your Rule 31.

This petitioner on review filed a personal holding company return for the year 1941 with the Collector of Internal Revenue for the First District of California, whose office is located at San Francisco, California, within the Ninth Judicial circuit, where this review is sought. No personal holding company return was filed for any of the years 1938, 1939, 1940 and 1942. Pursuant to Section 1141(b) (2) of the Internal Revenue Code this petitioner and the [46] Commissioner of Internal Revenue have by stipulation in writing designated the United States Circuit Court of Appeals for the Ninth Circuit as the Court of review under this petition for review.

NATURE OF CONTROVERSY

The question involved is whether petitioner may deduct depreciation and expenses in connection with the lumber boats Idaho and Oregon.

Throughout the five tax years 1938 to 1942, both inclusive, petitioner was the owner of the lumber steamer Oregon and the owner of a 75% interest in the lumber steamer Idaho, both of which steamers

it had laid up in 1929 and not operated thereafter to the end of 1942. The depreciation and expenses of said vessels (claimed and allowed for ordinary income tax purposes) for the five years in question were as follows:

Year	Total	Depreciation	Other Expenses
1938	\$12,459.96	\$10,002.08	\$2,457.88
1939	15,094.35	10,002.08	5,092.27
1940	15,028.68	10,002.08	5,026.60
1941	16,166.87	10,002.08	6,164.79
1942	12,898.05	10,002.08	2,895.97

This petitioner claimed and claims that it may make deductions thereof in computing Title 1A and Subchapter A net income under section 406(b) of the Act of 1938 and corresponding section 505(b) of the Internal Revenue Code. The Commissioner disallowed the deductions and the Tax Court sustained the disallowance and held against deductibility.

/s/ GEO. M. NAUS

Attorney for Petitioner on Review.

[Endorsed]: T.C.U.S. Filed June 30, 1948. [47]

[Title of Circuit Court of Appeals and Cause.]

STATEMENT OF POINTS

Comes now the petitioner on review herein by its attorney of record, and states the points on which it intends to rely on the review herein, to-wit:

The Tax Court of the United States erred in matter of law and its decision was not in accordance with law:

1. In concluding and holding, upon the facts found, that there were deficiencies in personal holding company surtaxes for the years 1938 to 1942, both inclusive.

2. In concluding and holding, upon the facts found, that petitioner's depreciation and expenses in connection with the boats Idaho and Oregon were not deductible.

3. In that its opinion and decisions are, upon the facts found, contrary to law in the matter of personal holding company surtaxes.

/s/ GEO. M. NAUS,

Attorney for Petitioner on Review.

[Endorsed]: T.C.U.S. Filed June 30, 1948. [48]

[Title of Circuit Court of Appeals and Cause.]

STIPULATION DESIGNATING VENUE

Pursuant to Section 1141(b)(2) the Commissioner and the taxpayer hereby designate the United States Circuit Court of Appeals for the Ninth Circuit as the Court to review the decision of The Tax Court entered May 18, 1948 in the above-entitled Docket Number, upon the petition

for review filed, or about to be filed, by the above-named petitioner Wilson Bros. & Co.

Dated June —, 1948.

WILSON BROS. & CO.,
a corporation,

By /s/ F. A. WILSON,
President.

/s/ GEORGE M. NAUS,
Attorney for Petitioner.

COMMISSIONER OF
INTERNAL REVENUE,

By /s/ THERON L. CAUDLE,
Assistant Attorney General, Attorney for Respondent.

[Endorsed]: T.C.U.S. Filed June 30, 1948. [49]

[Title of Circuit Court of Appeals and Cause.]

DESIGNATION OF PRINTING

Comes now the petitioner on review herein, by its attorney of record, and pursuant to Rules 19(6) and 31(3) of the Ninth Circuit Court of Appeals, relies upon and designates the entire record certified by the Clerk of the Tax Court, and directs that it be printed under the supervision of the Clerk of the Circuit Court of Appeals as the record on review.

/s/ GEO. M. NAUS,
Attorney for Petitioner on Review.

[Endorsed]: T.C.U.S. Filed June 30, 1948. [50]

[Title of Circuit Court of Appeals and Cause.]

ADMISSION OF RECEIPT OF SERVICE
COPIES OF REVIEW DOCUMENTS

The undersigned counsel for Respondent on Review hereby admit receipt of service copies of the following documents on review:

1. Petition for review.
2. Notice of filing petition for review.
3. Statement of points.
4. Designation of contents of record on review.
5. Designation of printing.

Dated at Washington, D. C., the 2nd day of July, 1948.

/s/ CHARLES OLIPHANT (CAR),
Counsel for Respondent on Review.

[Endorsed]: T.C.U.S. Filed July 2, 1948. [51]

[Title of Circuit Court of Appeals and Cause.]

DESIGNATION OF CONTENTS
OF RECORD ON REVIEW

To the Clerk of the Tax Court of the United States:

You will please prepare, certify and transmit to the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit a typewritten copy of the record on review herein. Petitioner designates the following portions of the record and proceedings in the Tax Court to be contained in the record on review:

1. Docket entries.

2. Pleadings: (a) Petition for Review of Deficiency Determinations. (b) Answer.

3. Opinion promulgated February 5, 1948 (10 T.C. No. 30).

4. Decision, entered May 18, 1948.

5. Petition for review.

6. Notice of filing petition for review.

7. Statement of points.

8. Designation of contents of record on review.

9. If the respondent on review should, pursuant to [52] Rule 75(a) FRCP, designate any additional portions of the record and proceedings, then: (a) Respondent's designation. (b) The additional portions designated by respondent.

10. Stipulation designating venue.

11. Designation of printing.

12. Admission of receipt of service copies of review documents.

13. This designation.

/s/ GEO. M. NAUS,

Attorney for Petitioner on Review.

[Endorsed]: T.C.U.S. Filed June 30, 1948. [53]

The Tax Court of the United States, Washington
[Title of Cause.]

Docket No. 11853

CERTIFICATE

I, Victor S. Mersch, clerk of The Tax Court of the United States, do hereby certify that the fore-

going pages 1 to 53, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia, this 13th day of July, 1948.

(Seal) /s/ VICTOR S. MERSCH,
Clerk, The Tax Court of the United States.

[Endorsed]: No. 11980. United States Circuit Court of Appeals for the Ninth Circuit. Wilson Bros. & Co., Petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Upon Petition to Review a Decision of The Tax Court of the United States.

Filed July 19, 1948.

 /s/ PAUL P. O'BRIEN,
Clerk of the United States Circuit Court of Appeals for the Ninth Circuit.

